

KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.

1301 K STREET, N.W.
SUITE 1000 WEST
WASHINGTON, D.C. 20005-3317

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
AUSTIN C. SCHLICK
STEVEN F. BENZ
NEIL M. GORSUCH
GEOFFREY M. KLINEBERG

(202) 326-7900
FACSIMILE
(202) 326-7990

January 26, 1998

1 COMMERCE SQUARE
2005 MARKET STREET
SUITE 2340
PHILADELPHIA, PA 19103
(215) 864-7270
FACSIMILE: (215) 864-7280

RECEIVED

Ex Parte Filing

Ms. Magalie Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

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JAN 26 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In re Matter of the Pay Telephone Reclassification and Compensation Provisions
of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Ms. Salas:

On Friday, January 23, Professor Jerry Hausman, Marie Breslin of Bell Atlantic, and I met with Rose Crellin, Craig Stroup, and Greg Lipscomb of the FCC to discuss Professor Hausman's declarations in this proceeding.

Professor Hausman illustrated, using several numerical examples, that under any realistic account of demand conditions, per-call compensation for dial-around and subscriber 800 calls should exceed the local coin rate. Professor Hausman agreed to provide additional documentation regarding his calculation of optimal price using his demand elasticity analysis; that documentation is attached hereto.

Professor Hausman also stated that, if the Commission decides not to rely on the relative elasticities of demand for different call types, it would be better for the Commission to employ a "top-down" avoided cost methodology than a "bottom-up" cost-based methodology. This is because it is preferable to anchor the per-call default rate in the market. Because there is always uncertainty in calculating costs, there is a greater opportunity for error in a "bottom-up" calculation. At the end of the day, the bottom-up and top-down numbers should be about the same, but the Commission should have greater confidence in the top-down number.

Professor Hausman also addressed some weaknesses in the E-Group Study that MCI had submitted, noting that the study purported to prove that rationing is better than the free market. The study neglected to consider that by mandating a lower price, the Commission would not only reduce the price, it would also suppress supply, leading to a large loss in consumer surplus.

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This might not be true if payphone providers had market power, but the E-Group's calculations did not reflect any such market power. Professor Hausman also stated that the E-Group study failed to take account of simultaneous equation problems: the fact that the study depended on regulated rates would not ameliorate this problem, so long as the regulated rates themselves took costs into account.

In addition, Professor Hausman explained why arguments that location providers have market power are incorrect. Rents in the vicinity of 55th St. and 5th Ave. in New York City are far higher than the rents 30 blocks to the south. But no one would argue that the owners of real estate in either neighborhood have market power. Likewise, to deny location owners commission would be to deny them the benefit of the value of their property. Professor Hausman gave the example of an airport, where a stretch of wall space can be used for a newsstand or for a bank of payphones. If per-call compensation is set too low, the number of payphones will be reduced.

Finally, Professor Hausman stated that it is not inconsistent to say that coin mechanism costs should be allocated across all calls, while ANI ii costs should be allocated only to coinless calls. The coin mechanism lowers the average costs of all calls, including coinless calls, so the coin mechanism is a necessary part of the payphone -- indeed, it is rare to see a coinless set. If coin mechanism costs are recovered through coin calls alone, the coin calls will be cross-subsidizing the coinless calls. Professor Hausman stated that he believed such cross-subsidy to be inconsistent with the intent of Congress in adopting the Telecommunications Act of 1996. On the other hand, ANI ii provides no benefit to local coin callers.

One original and one copy of this letter are being submitted to you in compliance with 47 C.F.R. § 1.1206(a)(2) to be included in the record of this proceeding. If you have any questions concerning this matter, please contact me at (202) 326-7921.

Yours sincerely



Aaron M. Panner

Enclosure

cc: Rose Crellin
Craig Stroup
Greg Lipscomb

Formula: $\frac{\Delta Q_1}{Q_1} = \frac{\Delta Q_2}{Q_2}$

Coin calls:

$$\frac{Q_1^1}{Q_1^2} = \left(\frac{.04}{.35} \right)^{-.663} = 4.213$$

Subscriber 800:

$$\frac{Q_2^1}{Q_2^2} = \left(\frac{.05}{x} \right)^{-.539} = 4.213$$

$$x = .72$$

Die Around:

$$\frac{Q_3^1}{Q_3^2} = \left(\frac{.05}{x} \right)^{-.117} = 4.213$$

$$x > 1.00$$